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215

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IMPACT OF THE SINO-INDIAN BORDER WAR ON THE INDIAN ECONOMY

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IMPACT OF THE SINO-INDIAN BORDER WAR ON THE INDIAN ECONOMY

The main impact of the Sino-Indian border war on India's economy will be reflected in the revision of economic plans and the adjustments in resource allocation required to meet the new situation that confronts the Indian leadership. Until very recently, India had developed its economic plans in an atmosphere that anticipated no major threat to its borders. The administration had permitted itself to reduce the share of military expenditure annually in an effort to increase governmental expenditure for investment and popular consumption in spite of significant excess capacity both in military and in nonmilitary production sectors and in spite of the assumption of a fractious attitude toward its most powerful neighbors.

By mid-November of this year the actions of Indian leaders suggested a revision of their basic assumption concerning the necessity for domestic military output and a consequent revision of governmental expenditure patterns toward basic defense and supporting industries. India also is seeking military assistance to provide the materiel required immediately to prosecute the border war and to begin the modernization of their defense industry. The immediate need is for foreign assistance to get military production rolling quickly. India's foreign exchange shortage is critical, and it will be necessary for liberal credit terms to be arranged.

The widespread unemployment and underutilization of Indian labor resources imply that the manpower for increased military mobilization and industrial production, including workers with technical training, could be furnished without a major depressing effect on the level of current output. Moreover, the increased national awareness associated with partial mobilization and an identifiable external threat will create opportunities to break down some of the traditional barriers to labor productivity and economic organization and planning that have been the major deterrents to past Indian economic development.

Similarly, the existence of excess capacity in Indian defense and capital goods industries indicates that defense production could be expanded somewhat without a diversion of equipment from other uses. To achieve the level and type of military output now considered essential by Indian leaders, however, additional investment in these industries will be necessary. The primary impact of the shifts in investment on present investment plans probably will fall on the equipment industries producing for durable consumer goods manufacturers, the chemical equipment industry, and those sectors of ferrous and nonferrous metallurgy that do not contribute directly to the development of military production and investment. It should be understood that the current ambitious Indian economic development program is falling behind schedule, and it seems likely that its optimistic investment plans would have been scaled back even in the absence of an invasion threat. Nevertheless, because a substantial amount of investment in defense industries is capable of alternate uses, much of this investment will not be lost to the economy but in the future could provide a flow of nonmilitary output.

The Economic Situation

The immediate effect of the Sino-Indian border war on India's economic development program undoubtedly will be an emphasis on those targets of the Third Five Year Plan (April 1961 -- March 1966) that can make the greatest contribution to the basic economy and basic defense needs.

Aside from the defense industry itself, whose potential is discussed elsewhere in this paper, priority attention is likely to be given to heavy industry and transportation. In addition, all possible effort probably will be made to maintain and possibly to increase investment and production in agriculture, partly to ward off inflation.

It is believed that adjustments can be made to gear up the military end-product industries without seriously impeding Indian economic progress. Indeed, it is altogether possible that India may realize a more efficient utilization of manpower and resources under circumstances of external threat. Communist Chinese aggression has created a greater feeling of national unity and purpose than has existed since India gained its independence. Even a minor improvement in employment and productivity rates stemming from this new enthusiasm could have a significant impact on Indian economic rates of growth.

Furthermore, India has the flexibility and resources to increase its rate of government expenditure without serious pressure on the money supply. There is no reason to suspect that moderate deficit spending in an economy with widespread underemployed resources would result in unmanageable inflationary pressures, at least in the short run. In fact, it is probable that the initial impact of such spending would bring idle resources into production with relatively little effect on prices -- provided the necessary raw materials can be supplied under liberal credit terms from foreign sources. A price stabilization program covering essential goods -- food and clothing -- has been announced by the Indian Government. In addition, a network of consumer stores will be set up, more wheat will be released from government stocks, and efforts will be made to increase cloth production. These measures, together with the patriotic surge engendered by the crisis, will hopefully keep hoarding and profiteering to a manageable minimum. In fact, measures arising from the mobilization effort not only could help to solve the chronic underemployment situation in India and the underutilization of industrial capacity in some areas but also could contribute substantially to increasing production.

Indian statistical reporting indicates the existence of substantial underutilization of production capacity. The extent of this failure to utilize fully existing capital is greatest in the basic industries that supply materials for the military establishment and among the capital equipment suppliers for the consumer goods industries. Even in the consumer goods industries, where it has been alleged that shortages are greatest, there is an element of excess capacity. Inspection of capacity-utilization statistics over several years indicates a chronic tendency to understate capacity and thus a tendency to overstate utilization of capacity.

Recent additions to installed capacity in several key areas have led to less than commensurate increases in output for these areas. For example, additions that doubled the installed capacity in the iron and steel industry led to an increase in iron and steel output of about 20 percent. Not only are imports of necessary raw materials and parts limited by India's tight foreign exchange position, but also there is a lack of followup in the planning, execution, and operational maintenance of existing plants. For the development-oriented Indians (and this is true in many developing countries) it is easier to generate enthusiasm for creation of new projects than it is to meet the challenge of fully utilizing established plants.

Table 1

Percentage Change in Installed Capacity and Output
for Selected Indian Industries
1960/61 - 1961/62 a/

	Installed Capacity	Production
Pig iron	+97	+17
Finished steel	+107	+21
Stationary diesel engines	+15	-3
Automobiles	+1	-4
Jute manufacturing	Nil	-6
Cement	+8	+7

a. Indian fiscal year, April-March.

A recent study of import statistics indicates substantial unused domestic capacity in production of certain goods that were being purchased abroad and paid for with scarce foreign exchange. Prominent items in this category are steel pipes and tubes, steel files, copper tubing, wire rope, and lead sheet.

There appear to be exceptional opportunities for a considerable increase in production in key areas of the Indian economy, such as the basic iron and steel industry, with no increase in capital investment. (Existence of excess capacity in the munitions industry is dealt with elsewhere in this paper.)

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The flow of external assistance for India's Third Five Year Plan is expected to continue. There are no firm indications that India seriously intends to seek substantial diversion of economic credits for military end use, [redacted] The US has made it clear that previously extended economic aid will remain earmarked for development purposes. The government of India is basically assured of external support for the development program through the second year of the Third Five Year Plan, ending in April 1963. In all likelihood the government will make every possible effort to fulfill its role in those projects for which foreign aid is available.

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Although the pace and scope of India's defense effort cannot be foreseen very precisely at the moment, it is believed that it could be carried out without a major negative impact on Indian economic development and even perhaps with positive effects in some sectors. Trouble spots do exist, however, in the economy. Activity during the first 2 years of the present Five Year Plan indicates that India would have been unable to fulfill its Plan goals under recent administration of its economic affairs even in the absence of the present conflict with Communist China. In fact, the main weakness in the Indian economy probably lies in a lack of managerial skills. Nevertheless, although the organization and conduct of economic affairs leaves much to be desired, the Indian economy is not considered to be in serious trouble.

Indications that India's Third Five Year Plan would not reach targeted objectives this year (1962/63) include the following trouble spots:

Exports

As of October 1962 it appears quite certain that exports in 1962/63 will fall short of the target, $1,512 million. On the basis of statistics for the first quarter (April-June 1962) it is estimated that the value of exports in this fiscal year will range between $1,386 million and $1,407 million, approximately the same as in the previous year ($1,390). Underlying the forecast are lower returns from major and traditional export items -- lower prices for jute and tea in particular -- and no over-all improvement in other export lines in spite of promotion activity.

Agriculture

Preliminary estimates for 1962/63 indicate that agricultural production generally will be higher than in the previous year. Progress in the agricultural sector has been slow, however, and even if production of foodgrains and pulses (the most important categories in the agricultural sector) reaches the 81 million metric tons forecast, this amount would represent only the achievement of targets established for 1960/61. The target of the Third Five Year Plan for foodgrains and pulses is slightly more than 100 million metric tons by 1966. In order to meet this target, annual production in 1962 should be about 88 million metric tons.

Unfavorable weather and inadequate supplies of chemical fertilizer have contributed to the disappointing increase in agricultural production. A rapidly increasing population has made the per capita result of this output even more unsatisfactory.

Inasmuch as agricultural income constitutes about half of India's national income, a relatively constant or only slowly growing agricultural output will seriously depress the average improvement in national income. If this estimate of agricultural production proves to be correct, the increase in national income in 1962/63 may be no more than 2 to 3 percent. This follows an increase for 1961/62 of slightly more than 2 percent in national income as against a rise of 7 percent in the preceding year. The Third Five Year Plan requires an annual increase in national income of about 5 percent.

Industrial Production

In spite of the decline in the annual rate of increase in industrial production in 1961 (the first since 1957), industrial production remains the strongest influence for economic growth in India today. In large measure the decline in the growth of industrial output is a product of a serious lag in transport capacity and in the operation of the existing productive capacity. Failure to meet output targets in electric power, in part caused by the inability to haul coal when mined as well as by lagging output at the mines, resulted in power failures in several large cities that led in turn to reduced output in many major industrial centers. Thus acute power shortages occurred at some industrial centers, while at the same time a number of large electric stations were operating at only 50 to 75 percent of capacity.

Planned rates of expansion in transport and power probably are less than needed for 1962, but a directive to accord special priorities in foreign exchange and construction to these sectors may raise the level of actual (as opposed to planned) investment sufficiently to permit substantial operational improvement. Even with increased attention, these sectors would constitute a limitation on the expansion of military output unless some substantial redirection of new capacity were undertaken.

Output of steel, coal, cement, and fertilizer were all short of plan during 1961, while effective demand for many of these commodities exceeded production targets for 1961. Output of steel for 1962 shows every promise of meeting planned levels, but transport and power shortages are likely to perpetuate the shortfalls in 1961 in the other industries.

The general industrial production index for the first half of 1962 was 7 to 8 percent above the same period of the previous year in spite of a poor showing in cotton textiles, which constitute almost one-half of the index weights. Output of jute and chemicals, as well as steel, has increased sharply. Output of coal for the first half of 1962 has improved markedly, although it remains substantially under Plan goals. In short, industrial production for 1962 will be much like that for 1961. The Sino-Indian Border War as such will exercise little impact on industrial production for the calendar year of 1962.

Table 2

Index of Industrial Production

	1951 = 100	Annual Increase (Percent)
1957	136.4	
1958	139.0	1.9
1959	149.5	7.6
1960	167.3	11.9
1961 a/	180.5	7.9

a. Provisional.

Foreign Exchange Position

India's present foreign exchange reserves are $196.6 million, down about $100 million during the past year. At the same time that reserves have been dwindling, foreign exchange requirements for maintenance of imports under the Third Five Year Plan have been revised upwards. (A recent estimate by the American Embassy indicates that a billion dollars additional in foreign aid would be necessary to meet plan goals.) Because of India's weakening foreign exchange position, procurement of complex military equipment from abroad and technical assistance for the manufacture in India of advanced military hardware will have to be acquired on generous payment terms.

India's Defense Mobilization Potential

The expansion of India's munitions industry during World War II left the country with substantial excess capacity, part of which has since been devoted to peacetime production of metal goods for non-military uses. Although self-sufficiency in military production has been a long-term goal of the Indian Government and although capacity exists outside defense industries that would have made its achievement feasible, this objective has been subordinated to nonmilitary economic development programs. Thus India has deferred the development of capability for domestic production of modern aircraft and ground equipment, depending on foreign sources for such weapons and equipment. The UK has been the principal source of ground equipment, while aircraft have been purchased from the UK, France, the US, and the USSR. Previous Soviet offers to sell MIG-21's and aid in the establishment in India of MIG manufacturing facilities are still considered firm by the Indian Government.

Indian military units have been underequipped in both quantity and quality by recent Western standards, as the government has sought to temporize on defense expenditures until greater progress could be achieved in India's basic economy. Although Indian defense spending in fiscal year 1962 was at a record high, it represented a declining share of total government expenditures -- a decline that has persisted throughout the past 10 years. Although Indian defense expenditures have maintained a relatively constant relation to national income, varying around 2 percent of the latter, this is a small share even for a nation at an early stage of development. Burma, for example, spends more than 7 percent of the national income on defense.

The decline in the importance of defense spending has been, in large part, a reflection of the increasing priority afforded the economic development program with its large government investment program. Government investment is currently 3 to 4 times greater than defense spending, while total investment (including private investment) is more than 5-1/2 times greater.

As a result of these expenditure policies, India's government-owned defense plants are presently handicapped by outmoded and poorly maintained equipment and machinery and by some shortage of skilled technical and managerial personnel. Production has generally concentrated on World War II type infantry and light artillery weapons and ammunition, which have proved inferior in recent engagements to those used by the

Table 3

Indian Defense Expenditures
1952-62

Fiscal Year a/	Total (Million US $)	As a Percent of Total Government Expenditures	As a Percent of National Income
1952	389	35.5	1.8
1953	412	32.9	1.9
1954	410	24.7	2.0
1955	399	22.6	1.9
1956	445	19.0	1.9
1957	587	17.5	2.5
1958	586	17.4	2.2
1959	561	14.7	2.1
1960	590	14.4	2.0
1961	688	13.9	N.A.
1962 b/	781	12.8	N.A.

a. Starting 1 April.
b. This figure will be boosted by about $200 million as a result of a supplemental appropriation in November 1962.

Chinese. Although production can be substantially increased with existing plant, a major retooling and machinery replacement program will be required if India is to equip its ground forces with more modern weapons from domestic sources. The process of retooling could be phased together with a program of transferring and training skilled workers and technicians now in other industries or presently underemployed in defense industries. The necessary programs will require foreign machinery and technical assistance as well as certain manufacturing rights. The Indian Government has requested such machinery from the US. Given this assistance and the determination to carry out such a program, India could again supply a modern army of considerable size as it did in World War II, when the bulk of ordnance supplies for the Indian forces of about 2.5 million, as well as substantial amounts of munitions for British forces, were supplied from Indian factories.*

* All of these factories remained in India at the time of partition.

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The Indian aircraft industry, in spite of the fairly modern and extensive facilities of Hindustan Aircraft, Ltd., at Bangalore, is not in a position to supply India's needs for combat and transport aircraft. Development of the HF-24 supersonic jet fighter beyond the prototype stage has been slowed by problems of procurement of a suitable engine. The diversity of aircraft now in the Indian Air Force inventory, which will be further complicated if MIG-21's are added, creates formidable problems of maintenance and spares. Although the use of the plant at Bangalore and the maintenance facilities at Kanpur for repair and maintenance work on presently held or newly acquired foreign aircraft would seem the course of wisdom during the present crisis, it is probable that continued efforts will be made to produce the HF-24 and to undertake production of the MIG-21 if the Soviets remain willing.

Logistics

As long as the Sino-Indian Border War is confined to border areas where only relatively small forces can be supported on either side, it is believed that the Indian logistic problem, while posing military difficulties, will not cause great impact on the Indian economy. Furthermore, if the Chinese choose to extend the war south of the Himalayas, Indian logistic problems rapidly diminish while those of the Chinese increase sharply. While the roads now extant will permit movement of limited supplies to combat areas, many Indian troops in forward areas can be supplied only by portages or airdrops. Fortunately, there are a number of forward airfields available for both operations and logistic support.

The Indians have at least 200,000 trucks in military and civilian use, approximately the same number as Communist China. The distances over which supplies must be trucked to the combat areas is, however, much shorter for the Indians than for the Chinese because of the availability of railroad transport in adjacent rear areas. The requirement for trucks and gasoline to maintain the Indian supply lines is accordingly much less and impinges far less on the total availability of these items to the military and the civilian economy. Existing Indian refinery capacity -- assuming sufficient imports of crude oil -- is considered to be sufficient to provide fuel for truck and air transport and for air operations.

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